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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK, As Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

vs.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF THE CROSS-PETITION FOR A WRIT OF CERTIORARI

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Cross-Petitioner Harris Trust and Savings Bank ("Harris Trust") submits this Reply Brief in response to the Brief in Opposition to Cross-Petition for a Writ of Certiorari filed by petitioner John Hancock Mutual Life Insurance Company ("Hancock").

Hancock attempts to minimize the significant conflict between the Second and Seventh Circuits with respect to the issues as to which Harris Trust seeks review.[1] As demonstrated in Harris Trust's Cross-Petition, the Second Circuit's interpretation of the scope of ERISA's fiduciary provisions conflicts with the Seventh Circuit in two respects:

(a) The Seventh Circuit has read ERISA's fiduciary provisions to reach conduct in all relevant respects identical to Hancock's in connection with its administration of GAC 50. The Second Circuit, on the other hand, declined to find that Hancock was a fiduciary in connection with its admitted exercise of unfettered discretionary control of the pension contract in issue.

(b) The Seventh Circuit has construed ERISA's fiduciary provisions as governing all aspects of an insurance company's conduct in connection with the investment of pension monies during the "accumulation" phase of an annuity contract. The Second Circuit, on the other hand, declined to do so.

Because the issues raised by Harris Trust in its Cross-Petition are serious points of conflict between the circuits, these issues clearly merit review.

Since the decision below concluded that ERISA reaches *only* free funds – those which Hancock admits are not associated with guaranteed benefits – the vast bulk of pension funds held

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[1] Hancock characterizes the issues presented in Harris Trust's Cross-Petition as "extraordinary propositions" and argues that the portion of the Second Circuit's Opinion as to which Harris Trust seeks review is "not inconsistent with any interpretation of ERISA published by the Department of Labor." Brief in Opposition at pp. 2-3. This is misleading in view of DOL Advisory opinions supportive of Harris Trust's position. Cross-Petition at pp. 19, 20. In any event, these assertions by Hancock are belied by the DOL's own inability to formulate a position on *any* of the issues presented to the court below, despite "an extensive review of the legal and policy issues involved in this matter" and the DOL's recognition that the case "was important and complex." Appendix to Hancock's Petition for a Writ of Certiorari, Docket No. 92-1072 (Dec. 22, 1992) (hereinafter "A-____").

in insurance company general accounts, estimated to be in excess of one-half trillion dollars,[2] would remain free of ERISA protection. Indeed, the *amicus* brief submitted by the New York State Superintendent of Insurance highlights the necessity of affording ERISA protection to pension plan general account contracts. In essence, the Superintendent has admitted that insurers routinely rely upon pension fund deposits to buttress other lines of business, and that state regulators approve of this practice. Moreover, these pension funds would become available to general creditors in the event of insurance company insolvencies. This attitude, which apparently is not atypical, highlights the importance of review by this Court of the issues presented in Harris Trust's Cross-Petition in the event Hancock's petition is granted:

Finally, in opposing the Cross-Petition, Hancock ignores the fact that the issues as to which Harris Trust seeks review are inextricably intertwined with the questions presented by Hancock in its Petition. Any review of the issues presented in Hancock's Petition will necessarily require this Court to examine the intent of Congress in creating a "guaranteed benefit policy" safe harbor under ERISA for certain types of group annuity contracts. This inquiry will require the Court to examine the overall regulatory scheme devised by Congress in ERISA, including such issues as whether Congress intended to regulate the investment activities of insurance companies with respect to general account pension contracts and the breadth of the Guaranteed Benefit Policy exemption. These issues will require an understanding of the issues presented in Harris Trust's Cross-Petition.

Accordingly, and for the reasons stated by Harris Trust below and in its Cross-Petition, if Hancock's Petition is granted, this Court should also review the questions presented by Harris Trust in its Cross-Petition.

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[2] Brief of *Amicus Curiae* American Council of Life Insurance in Support of Petition at p. 1.

I.

THE SECOND CIRCUIT'S DECISION THAT HANCOCK IS NOT A FIDUCIARY AS TO THE CONTRACT ITSELF IS IN CONFLICT WITH OTHER CIRCUITS AND IGNORED HANCOCK'S EXERCISE OF UNFETTERED DISCRETION WITH RESPECT TO THE ADMINISTRATION OF GAC 50

A. *The Second Circuit and the Seventh Circuit Are In Conflict on This Issue*

Hancock seeks to recast and narrow the scope of salient decisions of the Seventh Circuit, in an attempt to justify its claim that the court below did no more than "distinguish" such decisions as *Ed Miniat v. Globe Life Ins. Group, Inc.*, 805 F.2d 732 (7th Cir. 1986), *cert. den.*, 482 U.S. 915 (1987) and *Chicago Board Options Exchange, Inc. v. Connecticut General Life Ins. Co.*, 713 F.2d 254 (7th Cir. 1983) ("CBOE"). The Seventh Circuit correctly concluded in these and other decisions that there may be more than one fiduciary with respect to the contract itself, and that the exercise of discretion in pursuing its rights under a contract may subject an insurance company to ERISA's fiduciary requirements.

The Second Circuit, however, did more than distinguish these cases in concluding that "[o]nly Harris Trust as contractholder has discretionary authority over the guaranteed benefit *qua* policy" (A-13) and that Hancock "does not 'exercise[] any discretionary authority or discretionary control . . . respecting management or disposition of the policy itself." *Id.* In fact, this constricted reading of ERISA directly conflicts with the construction of the statute adopted by the Seventh Circuit.

First, the Second Circuit's conclusion that *only* Harris Trust, as contractholder, can be a fiduciary with respect to the policy itself, conflicts with *CBOE* and *Ed Miniat*. In both of those cases, the Seventh Circuit clearly held that there may be *more than one* fiduciary with respect to the contract

itself,[3] and that an insurance company's exercise of discretionary authority, even in circumstances where the contract is negotiated at arms length, rendered the insurance company an ERISA fiduciary.

Hancock's attempt to obscure this conflict is nowhere more evident than in its treatment of *Ed Miniat*. In its brief in opposition (at p. 6), Hancock relies upon a quotation from the *Ed Miniat* opinion to support its claim that an insurance company's mere reliance upon its contractual rights will not render it subject to ERISA's fiduciary provisions.[4] Hancock, however, tellingly omits the final sentence of the passage, in which the Seventh Circuit stated:

> When a contract, however, grants an insurer discretionary authority, even though the contract itself is the product of an arm's length bargain, the insurer may be a fiduciary.

805 F.2d at 737.[5] Finally, both Hancock and the court below also ignored a prior Second Circuit decision, *F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir. 1987).

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[3] Like the district court, the Second Circuit apparently fell into the trap of concluding that, because ERISA explicitly makes the person who holds a group annuity contract a fiduciary, that person is the *only* fiduciary. *Compare* A-13, A-61. This conclusion runs counter to the language of ERISA and countless cases, such as *Ed Miniat* and *CBOE*, in which *multiple* fiduciaries were charged with compliance with ERISA in their dealings with plan assets. *See also* 29 U.S.C. §1105.

[4] The facts of *Ed Miniat* belie this argument. The Seventh Circuit held that the insurer was a fiduciary because of its exercise of unilateral discretion, *granted in the contract*, to reduce the rate of return and increase premiums. *Ed Miniat*, 805 F.2d at 734, 737-38.

[5] Remarkably, Hancock seeks to buttress its already strained argument on this point by citing a recent Eleventh Circuit decision, *Useden v. Acker*, 947 F.2d 1563 (11th Cir. 1991), petition for cert. filed sub. nom., 60 U.S.L.W. 3843 (U.S. June 1, 1992) (No. 91-1944). *Useden*, however, is inapposite. It does not involve an insurance policy or a group annuity contract, which by *statute* are "plan assets." 29 U.S.C. §1101(b)(2). Instead, *Useden* decided whether a commercial lender assumes fiduciary status with respect to a pension plan borrower upon foreclosure, and as such has no relevance here.

There, the Second Circuit concluded that, *after* an entity contracts with a pension plan, "the agreement may give it such control over factors that determine the actual amount of its compensation that the person thereby becomes an ERISA fiduciary with respect to that compensation." The refusal of the court below to apply *F.H. Krear* to Hancock's conduct further illustrates the fundamental conflict between the Seventh and Second circuits on this point.

B. *The Court Below Ignored Uncontradicted Evidence of Hancock's Exercise of Discretionary Authority*

The court below, in attempting to distinguish *Ed Miniat* and *CBOE*, ignored its own finding that Hancock retained absolute discretion to terminate non-guaranteed benefit payments *for any reason* upon 31 days' written notice, and that Hancock's decision to do so did not breach the contract. A- 17-18. In addition, the district court concluded that Hancock had unfettered power at any time to terminate another arrangement under which the Plan had the right to withdraw excess "free funds" and therefore, Hancock's exercise of such discretion breached neither the contract nor any ERISA duties. A- 68-71. Finally, in dismissing the Trustee's common law claims concerning Hancock's breach of the contract's covenant of good faith and fair dealing, the district court again concluded that Hancock possessed and exercised virtually unfettered discretion with respect to investment and income allocation decisions and the like. A- 82-85.

In light of the district court's decision, the attempt by the court below to "distinguish" *Chicago Board* and *Ed Miniat* has created a conflict in the circuits on this issue. Standing alone, the exercise of unfettered discretion to permit or deny withdrawals of excess, *non-guaranteed* funds from its general account effectively gave Hancock the power to fundamentally alter the value of GAC 50 and clearly rendered Hancock a fiduciary with respect to the Contract. *Chicago Board* illustrates this point. There, the Seventh Circuit concluded that the insurer was an ERISA fiduciary to the extent it retained power to amend the contract, *thereby reducing or altering its value*:

> Nevertheless, the policy itself is a Plan asset, and Connecticut General's ability to amend it, and thereby alter its value, is not qualitatively different from the ability to choose investments. *By locking CBOE into the Guaranteed Accounts for the next 10 years Connecticut General has effectively determined what type of investment the Plan must make.* In exercising this control over an asset of the Plan, Connecticut General must act in accordance with its fiduciary obligations.

Chicago Board 713 F.2d at 260 (emphasis added).

Moreover, Hancock's decision to retain free funds by terminating the "rollover" arrangement and the payment of non-guaranteed benefits substantially increased its compensation, by raising its risk charges and expense recoveries and improving its "cash flow." Indeed, the very witnesses upon whom the district court relied in concluding that Hancock' possessed the contractual right to terminate the withdrawal of excess funds testified that Hancock's right to do so was designed to protect its own "cash flow." *See* J.A. 1334, 1762.[6] The ability to protect its cash flow and to enhance its fees and charges is effectively a determination of the amount of its compensation and renders Hancock a fiduciary. *F.H. Krear, supra.*

Hancock's exercise of unfettered discretion with respect to withdrawals and compensation clearly resulted, as in *Chicago Board*, in an alteration of the value of GAC 50 by locking substantial free funds into Hancock's general account. Thus, Hancock "must act in accordance with its fiduciary obligations." *Chicago Board*, 713 F.2d at 260.[7] Accordingly, the court below erred in concluding that Hancock was not a fiduciary with respect to the contract and its analysis of the scope of ERISA in this regard has created a clear conflict between the circuits.

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[6] "J.A.____" refers to the pages of the parties' Joint Appendix submitted in connection with the appeal to the Second Circuit.

[7] Any decision that allows insurance companies, under the guise of merely complying with provisions in contracts granting them, as here, unfettered discretion, to avoid compliance with ERISA creates a huge void in the Congressional intent to protect pension funds.

II.

THE COURT BELOW IS IN CONFLICT WITH A SEVENTH CIRCUIT DECISION THAT CORRECTLY CONSTRUED ERISA AS PROTECTING ASSETS SUCH AS THE FUNDS INVESTED UNDER GAC 50 WHICH ARE SUBJECT TO INVESTMENT FLUCTUATION

The court below concluded that *only* the "free funds" in the plan's Pension Administration Fund ("PA Fund") are governed by ERISA's fiduciary responsibility provisions. By so doing, the court below ignored the sound reasoning underlying the Seventh Circuit's decision in *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 327 (7th Cir. 1983), which held that, while a general account fund holding pension monies is in a "variable accumulation phase," it does not qualify for the "guaranteed benefit policy exemption." *See Peoria*, 698 F.2d at 327.

It is uncontroverted that the amount in GAC 50's PA Fund available to fund new benefits and for other plan purposes is dependent upon the investment experience of the Hancock general account and allocation of that experience to the PA Fund. J.A. 526, 530. The monies allegedly supporting benefits "guaranteed" by Hancock and the "free money" which may be used to provide future guaranteed or non-guaranteed benefits are all held in the PA Fund. Hancock does not separate those funds which are associated with guaranteed benefits. The *entire* PA Fund receives the benefits and detriments of Hancock's investment performance. J.A. 1641-1674. Accordingly, *all* funds held in the PA Fund and the contract's "Contingency Account" are "attributable" to the "variable part" of GAC 50. S. Rep. No. 93-127, 93rd Cong., 2d Sess. (1974), *reprinted in* 3 Code Cong. & Admin. News 5038, 5077.

The funds supporting the benefits "guaranteed" by Hancock and the "free funds" in excess of the minimum level are commingled and invested together by Hancock. The *entire* fund earns income and generates additional "free funds" to be used

for new benefits and for other plan purposes. Thus, the court below is in direct conflict with the Seventh Circuit in holding that the monies invested by Hancock in its general account, which generated funds admittedly not associated with "guaranteed benefits," are beyond the reach of ERISA.

Because Hancock has elected not to segregate the "guaranteed" from the variable, non-guaranteed portion of GAC 50's funds, the entire PA Fund should fall within the broad remedial requirements of ERISA's fiduciary responsibility provisions. *See, e.g., Smith v. CMTA-IAM Pension Trust*, 746 F.2d 587 (9th Cir. 1984). Accordingly, as in *Peoria*, the entire PA Fund should be considered to be in the "variable accumulation phase," thereby subjecting Hancock to ERISA's fiduciary duty provisions. The Second Circuit's failure to grasp this point thus created a clear conflict as to the two circuits' analyses of this key statutory provision.[8]

III.

THE ISSUES RAISED IN HARRIS TRUST'S CROSS-PETITION ARE INTERTWINED WITH THE ISSUES AS TO WHICH HANCOCK SEEKS REVIEW

As illustrated above, the issues raised in Hancock's petition and Harris Trust's cross-petition are inextricably intertwined. In order to determine whether the Second Circuit erred in imposing fiduciary duties upon Hancock in connection with Hancock's handling of GAC 50's "free funds," this Court must necessarily examine and articulate the scope of the "guaranteed

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[8] In its Brief in Opposition (at 14, n. 19) Hancock seeks to avoid the impact of relevant Department of Labor Advisory Opinions which support the approach to this issue adopted by *Peoria* and rejected by the Second Circuit, arguing they are "merely advisory opinions." Hancock's willingness to pick and choose the DOL opinions this Court should consider, however, is unseemly in light of Hancock's own heavy reliance upon a misreading of DOL Interpretive Bulletin IB 75-2, which pre-dates the DOL opinions on which the Second Circuit relied. Moreover, while Hancock correctly notes that the district court below refused to give credence to these Advisory Opinions, they were *relied upon* by the circuit court.

benefit policy" exemption. In so doing, this Court must determine the extent to which Congress intended to regulate insurance industry practices concerning the investment of pension funds in general accounts. This examination will result in determinations which bear directly upon the issues presented in the Cross-Petition. Thus, granting the cross-petition will allow this Court to delineate the contours of federal law in this important area in a comprehensive fashion, thereby eliminating the conflicts described above and resolving the uncertainties in this area cited by Hancock and *amici*. For this additional reason, Harris Trust's cross-petition should be granted.

Conclusion

The Cross-Petition for a writ of Certiorari should be granted in the event the Petition is granted.

Dated: New York, New York
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Respectfully submitted,

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